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Department of Justice

BONNIE J. CAMPBELL

ADDRESS REPLY TO:

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

IN THE MATTER OF Amendments of Parts 32, 36, 61, 64, and 69 of the Commission's Rules to Establish and Implement Regulatory Procedures for Video Dialtone Service	RM-8221

COMMENTS OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES (NASUCA)

I. INTRODUCTION

On April 8, 1993, the Consumer Federation of America (CFA) and the National Cable Television Association (NCTA) filed with the Commission a Joint Petition for Rulemaking and Request for Establishment of a Joint Board, to address the separations, accounting, and cost allocation issues surrounding joint use of facilities which provide both telephone service and video dialtone service. The National Association of State Utility Consumer Advocates (NASUCA), a national association of 42 state-authorized members representing utility consumers in 38 states and the District of Columbia, files these comments on the Joint Petition pursuant to the Commission's Notice of April 21, 1993. NASUCA members have an active interest in questions relating both to jurisdictional separations and to cost allocation between various services, by virtue of their duty to represent the interests of telephone customers.

NASUCA believes that the Joint Petition raises important questions which need to be resolved at the earliest opportunity. In particular, failure of the Commission to promptly identify and implement adequate separations and allocation mechanisms will likely lead to the subsidization of interstate services by intrastate services, and of new video services by telephone service. Consequently, NASUCA submits these comments in support of the commencement of a rulemaking proceeding and the establishment of a Joint Board as requested by the Joint Petitioners.

II. THE NEED FOR ACTION ON SEPARATIONS

NASUCA agrees with the Joint Petitioners that existing separations procedures were not intended to deal with the problems that are present when voice, data, and video services are provided over the same facilities.[1] NASUCA emphasizes, however, that pending the revision of these rules by a Joint Board, the existing rules should be used in such a manner as to avoid improperly assigning to telephone service the costs of providing a network for video transmission.

The Joint Petitioners have recommended that pending the completion of this rulemaking, video dialtone applications should not be approved, or in the alternative, such approval should be conditioned on a later reallocation of costs.[2] NASUCA recognizes that any effort to revise current separations rules could require a considerable period of time while the Joint Board and Commission consider potential revisions. While NASUCA does not join in the request that pending and future video dialtone applications be denied until new rules are in place, it strongly supports Joint Petitioners' request that any approvals be clearly subject to retroactive application

[1] Joint Petition at 11-12.

[2] Joint Petition at 5.

of subsequent separations safeguards. Video dialtone applicants should be put on notice that they cannot expect captive local telephone customers to be guarantors of investment in video dialtone facilities simply because such investment may be jointly used to provide telephone service.

NASUCA is also concerned with the possibility that the Commission may not address the issue of proper separations procedures at all in approving pending video dialtone applications. In that event, no clarification of this issue would occur even while various facilities are constructed and equipment installed to provide video dialtone service. NASUCA emphasizes that, if the Commission approves video dialtone applications, it must apply existing separations rules in such a manner as to avoid the type of cost shifting noted by both the Joint Petitioners and NASUCA.

It is particularly inappropriate to assign all of the cost of fiber trunks to exchange service even though "[t]he bandwidth used for telephone service pales in comparison to the wideband facilities used for video."[3] Similarly, it would be a gross misallocation of costs to assign 75% of the subscriber loop through which video may pass to the intrastate jurisdiction while considering 100% of video revenues as interstate.[4]

NASUCA believes that the existing separations rules do not require this misallocation of costs. In fact, in a recent New Jersey Bell response to Commission Staff questions, New Jersey Bell stated that it will apply some portion of shared costs to its video dialtone rates:

> If it receives 214 approval, NJB will submit a tariff that includes cost justification appropriate for a new service. In allocating costs, video dialtone will be assigned all direct costs, including a fair portion of shared costs for all common facilities

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[3] Joint Petition at 9.

[4] Joint Petition at 11-12.

> and overhead, including fiber, and overhead. NJB will directly assign those actual costs that it can identify and will provide additional assurances that there is no cross-subsidy. A general allocator will be used as a proxy to estimate the actual common costs.

Response to Commission Questions Regarding New Jersey Bell's Florham Park and Dover Section 214 Video Dialtone Applications, at 8, File Nos. W-P-C 6838 and 6840, April 30, 1993. However, the Commission has not directly addressed how costs should be separated between jurisdictions under the existing separations rules. NASUCA cautions that the Commission should not simply refrain from providing any guidance in the application of existing rules if it should rule upon any of the existing Section 214 video dialtone applications.

As the Joint Petitioners emphasize, the cost of subscriber loops jointly used for video dialtone and telephone service are separated 75% to the intrastate jurisdiction under existing rules.[5] However, the existing rules also require that, where subscriber loops are used exclusively for interstate purposes, such loops shall be directly assigned to the interstate jurisdiction. 47 CFR § 36.154(b). Such direct assignment would be appropriate, for example, where a separate coaxial drop is used exclusively to deliver video dialtone service. NASUCA also suggests that the existing rules require that the cost of wideband fiber optic trunks running within the exchange be assigned between jurisdictions based upon the number of equivalent channels. See 47 CFR §§ 36.152(a)(2) and 36.155(a).

Such separations procedures could be clarified through the Joint Board process proposed by the Joint Petitioners. In the interim, however, the Commission should apply its own rules so as not to allow the current misallocation of costs noted by the Joint Petitioners. NASUCA

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[5] Joint Petition at 11-12.

emphasizes this point so that, while the Commission considers the Joint Petition, it continues to meet its obligation to maintain consumer safeguards through the various video dialtone § 214 applications and implements procedures which will prevent telephone customers from bearing costs incurred to provide video dialtone service.

III. THE NEED FOR ACTION ON COST ALLOCATIONS

The allocation of costs associated with providing video dialtone service is of critical importance to consumers. Although the Commission itself originally solicited comments regarding changes in the separations and cost allocation rules[6] and many commentors advocated the establishment of specific rules to apply in the video dialtone context,[7] the Commission declined to promulgate such regulations at the time it authorized video dialtone service. In rejecting the development of such rules, the Commission reasoned that it already had in place a "comprehensive system of cost allocation rules and cost accounting safeguards" to prevent cross-subsidization and other consumer abuses.[8] The Commission, however, expressly stated that it was "prepared to closely monitor the actual effects of such rules on cost allocations" in safeguards" at such time.[9] The Commission further expressed its willingness to propose any changes that will serve the public interest.[10]

At least three video dialtone applications are pending before the Commission[11], and U S West has expressed its intent to construct video dialtone systems throughout its service territory.[12] In addition, in March 1993 the Commission permitted the Chesapeake and Potomac Telephone Company of Virginia to offer a limited video dialtone trial to Bell Atlantic employees in Northern Virginia using ADSL technology.[13] Petitioners persuasively state that the video dialtone applications pending before the Commission raise such fundamental issues as whether fully distributed or incremental cost standards should be applicable to video programmers; the proper allocation of costs between video and telephone services; and the application of the Commission's accounting rules in the video dialtone context.

Among the more striking cost allocation issues raised is New Jersey Bell's prior proposal in which it assigned one hundred percent of the cost of fiber trunks, necessary for video service, to telephone ratepayers (on the theory that the purpose of the fiber installation is to upgrade

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[9] Id. at ¶¶ 89 and 92.

[10] Id. at ¶ 92.

[11] Application of New York Telephone Co., File No. W-P-C-6836 (filed Oct. 30, 1992); Application of New Jersey Bell Telephone Co. (Florham System), File No. W-P-C-6838 (filed Nov. 6, 1992); and Application of New Jersey Bell Telephone Co. (Dover System), File No. W-P-C-6840 (filed Dec. 15, 1992).

[12] News Release of U S West Communications, February 4, 1993.

[13] See Application of C&P, FCC 93-160 (rel. March 25, 1993).

telephone service.)[14] New Jersey Bell's proposal regarding fiber costs demonstrates how telephone ratepayers face the immediate risk that rates for non-competitive, network based services will be substantially increased to subsidize more competitive ventures such as video dialtone. To the extent that video services face more competition than telephone services, telephone companies have a great incentive to understate, through misallocation, the costs attributable to video service. If the true costs of video service are not assigned to video, telephone ratepayers become de facto investors in, and guarantors of, video service.

Consumers are at greatest risk when plant used for video dialtone (or any competitive service) is also used for telephone service. The U. S. General Accounting Office explained this behavior in a pre-divestiture report to the Congress:

> In addition to inadvertently misallocating joint and common costs, a regulated firm facing competitive entry in particular markets may have an incentive to classify as much cost as possible in categories which are not directly attributable to a specific service and also design its plant to be joint cost in nature. As a result, the directly attributable costs of producing competitive services appear "low" and the firm can then justify to the regulator low prices based on these apparently low costs for service facing competitive entry.[15]

In this situation, subsidies would flow from telephone to video service, resulting in higher telephone prices, lower video prices, an unfair competitive advantage to companies that provide both types of services, and unfair treatment for telephone customers.

As stated by the Joint Petitioners, telephone companies have the ability and the

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[14] Joint Petition at 8, citing NJ Bell Dover Application at 5; NJ Bell Florham Application at 5.

[15] GAO Report to Congress: Legislative and Regulatory Actions Needed to Deal with a Changing Domestic Telecommunications Industry (Sept. 24, 1981), at 65-66.

opportunity to misallocate costs.[16] Petitioners suggest the assignment of employees of regulated operations to work on projects benefitting unregulated operations as an example of cost misallocation. In fact, allowing an unregulated affiliate of the telephone company any role in owning or leasing equipment could permit cost shifts to regulated rates.[17] These situations present relatively clear opportunities for cross-subsidies. Also present, however, are opportunities which are much more subtle but no less important.

For example, depreciation may be accelerated on investment used to provide monopoly telephone service to generate cash flows for use in constructing video facilities which are subject to more competition. Shortened lives for these assets will give rise to depreciation reserve deficiencies and "stranded investment", typically recovered through the remaining-life mechanism of depreciation rates. This mechanism, however, provides no means to recognize the fact that the shortened depreciation lives have been caused by the desire to accelerate investment in relatively more competitive video services. Absent such a recognition, telephone customers will bear the brunt of these depreciation changes, even though those changes are caused by the desire to provide video service.

NASUCA believes that, absent rules of the Commission to ensure that jointly used plant is fairly allocated between video and telephone services, and between regulated and unregulated services, customers buying regulated telephone services will be forced to bear the costs of

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[16] Petition at 4.

[17] See Informal Comments of Consumer Federation of America, Application of C&P of Virginia, W-P-C-6834 (filed Dec. 17, 1992) at 5. CFA notes that in the Virginia trial, equipment will be owned or leased from Network Services, Inc., an unregulated subsidiary of C&P of Virginia.

installing a network used largely to provide video services. Unless an equitable cost allocation and separations process is in place, consumers cannot be assured that the additional costs of a video network will not be recovered by telephone ratepayers. Moreover, mere "minutes of use" is not an adequate basis for the allocations in question. Minutes of use do not take into account the great disparity in bandwidth necessary to provide voice versus video service.

Furthermore, even a measure recognizing this disparity may fail to properly allocate costs on the basis of causation. Assume, for example, that the driving force behind the installation of fiber optic trunks used to provide both voice and video service is the desire to provide video service. In their early days, when video services are in their infancy, such a trunk may carry primarily voice service. If the market for video service does not materialize, the trunk may carry primarily voice service for its entire useful life. Regardless of its use, however, cost allocation processes should recognize that the causative factor driving the installation of the fiber trunk was video service. The bulk of the cost of the trunk, as well as costs resulting from any premature retirement of previously installed copper cable, should be allocated to video service.

Finally, NASUCA urges the Commission not to formulate its policy on these critical cost allocation issues in an ad hoc manner. Petitioners have presented fundamental cost issues in need of immediate resolution. Addressing these cost issues on a case-by-case basis is administratively inefficient, and inconsistent with the public interest. Consumer groups generally do not have the resources to analyze and respond to each video dialtone application. A comprehensive analysis of each separate application can be prohibitively expensive, requiring analysis from accountants, economists, and engineers. The cost allocation and separations issues would be better handled in a single proceeding, where all interested parties would have the opportunity to develop and submit comments on these important issues. This approach would best give captive telephone ratepayers, those at greatest risk without comprehensive and equitable video dialtone cost allocation rules, the ability to fully participate in this matter. Accordingly, NASUCA supports the Petition filed by CFA and NCTA.

IV. THE NEED FOR ACTION ON ACCOUNTING RULES

NASUCA members are acutely aware of the importance of accounting records in analyzing the investments, expenses, and revenues of telephone companies. These records provide the necessary source of data for use in both separations and cost allocation analysis. As a result, it is imperative that the Commission ensure that this source of data will be useful in performing the kinds of analysis that will be necessary in a environment where voice and video services are jointly provided over the same network. Changes to existing accounting rules will be necessary in order to achieve this result.

As noted by Petitioners, the Uniform System of Accounts (47 CFR Part 32) should be modified so as to identify investment specifically on the basis of network architecture.[18] For example, to determine exactly what services should bear the costs of fiber in the network, it will become increasingly important <u>where</u> in the network this fiber is deployed. Because the existing system of accounts does not clearly differentiate between, for example, loop and trunk investment, those accounts will not be able to provide this necessary information. Thus, the absence of an adequate data source in a company's accounting records will greatly complicate

[18] Joint Petition at 16-17.

the cost allocation process.

The existing USOA also does not distinguish between investment in facilities for voice service, and investment in facilities for video service.[19] Thus, accounts such as central office terminal equipment will include investment in both voice and video facilities, frustrating the cost allocation process. Voice and video investment should be segregated on the accounting records to the maximum extent possible, either in separate subaccounts or through entirely new accounts for video investment.

IV. THE NEED FOR EVEN-HANDED TREATMENT

There is an obvious trend toward the convergence of the telecommunications industry and the cable industry.[20] As this environment develops, it becomes increasingly likely that the same companies will be providing both voice and video services to the home. When this is the case, the same separations, cost allocation, and accounting safeguards should be applied regardless of whether the company involved is a "cable company" or a "telephone company." The need to protect customers from abuse of monopoly power exists whenever monopoly market power exists, regardless of the identity of the provider of the monopoly service. Thus, any rules adopted in response to the Joint Petition should be even-handed in their protection of customers, regardless of the identity of the service provider.

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[19] Joint Petition at 17.

[20] Perhaps the most recent example is the announcement on May 17, 1993, of an agreement by which U S West would invest $2.5 billion in the cable operations of Time Warner Entertainment.

VI. CONCLUSION

The Joint Petition of the CFA and the NCTA raises important questions which must be resolved by the Commission. NASUCA supports the Joint Petitioner's request that a rulemaking be commenced, and a Joint Board be established, to consider these issues.

Respectfully Submitted,

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